

# **JESA INVESTMENT & MANAGEMENT CO., LTD.**

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## **Alitalia**

By Saro Capozzoli, Giulia Radice, Francesca Pozzan, Edoardo del Pia – Jesa

Dal primo Maggio 2015 Alitalia riaprirà la tratta aerea da Malpensa a Shanghai. La notizia della nuova rotta, che ha come destinazione una delle più popolose città della Cina, arriva in concomitanza con l'inizio dell'Expo di Milano, un evento questo, che si spera aumenti e incoraggi il turismo e gli investimenti in Italia. Perché' un investimento del genere, con lo scopo di supportare gli export Italiani, arriva tanto tardi?

Per rispondere a tale domanda e spiegare cosa è accaduto a questo collegamento nell'ultimo decennio vanno fatti alcuni chiarimenti. Negli anni 90, quando Shanghai non era ancora il centro economico e finanziario che oggi rappresenta, la compagnia aerea Italiana era stata la prima in Europa ad offrire ai suoi passeggeri un volo diretto per tale destinazione. Il vantaggio che Alitalia aveva conseguito come 'first-mover' non è durato a lungo dal momento che, in tale periodo, erano ben pochi gli italiani ad avere rapporti economici con l'Asia. Questi, se presenti, privilegiavano Pechino. Di conseguenza la rotta venne soppressa dopo poco tempo.

Pochi anni dopo, a seguito degli eventi del 9/11 nel 2001, mentre i voli aerei subivano una generale battuta d'arresto, Alitalia sospese i voli diretti per la capitale Cinese. Nel frattempo rivali come Lufthansa e AirFrance approfittavano della crescente domanda per voli con destinazioni quali Chengdu, Guangzhou e aeroporti minori come quelli di Nanjing, Wuhan e Xiamen, discostandosi quindi dalle classiche rotte.

Nel periodo dal 2001 al 2005 sempre più compagnie hanno implementato l'offerta di voli verso l'Asia; Malev, Turkish Airlines, etc. sono solo alcuni esempi di questo fenomeno. Così, mentre Lufthansa apriva 3 voli giornalieri da/per Shanghai su Monaco e Francoforte, Alitalia decideva di chiudere tutti quelli per la Cina!

Nel 2008, a causa di una strategia di tagli nei costi, la tratta verso Shanghai fu nuovamente sospesa dopo un breve periodo di attività. La perdita economica che Alitalia stava affrontando in quel periodo può essere ricondotta a vari fattori. Mentre l'azienda stava usando i datati Boeing 767, i suoi concorrenti stavano già utilizzando più moderni e grandi aerei quali i 747, 777 e A340. Allo stesso modo Alitalia si stava focalizzando sulle esigenze della clientela Italiana piuttosto che su quella Cinese. Infine la bassa frequenza di voli per e dalla Cina aveva fatto lievitare i costi e aveva reso l'offerta della compagnia meno attraente e profittevole (è infatti necessario un numero minimo di voli per ammortizzare i costi fissi, logistici e del personale).

Ci siamo chiesti perché la struttura dei costi fosse così alta rispetto ad altre compagnie aeree. Pur immaginandone le ragioni, non indagheremo le cause né discuteremo l'operato del management.

Ci preme invece sottolineare la notizia di riapertura della tratta diretta dei voli per e dalla Cina, che pensiamo gioverà sia ad Alitalia che a Milano e in generale al Nord-Est Italia. Nonostante ciò, non crediamo che i passeggeri provenienti dal Veneto e dalle regioni limitrofe sceglieranno di viaggiare dall'aeroporto di Malpensa, visto il traffico presente sull'autostrada A4 e nell'area di Milano. Finché importanti Aeroporti come Malpensa e Linate non saranno meglio collegati, non rappresenteranno una scelta primaria per molti passeggeri.

Nel caso specifico, gli aeroporti di Verona e Venezia presentano migliori e più congeniali offerte che collegano bene Francoforte, Monaco, Amsterdam, Vienna e da qui tutto il mondo.

Abbiamo già illustrato, nella nostra precedente newsletter, la crescente influenza di altre città Cinesi, oltre le principali già conosciute. Alitalia, insieme ad altri concorrenti Europei, non ha ancora realizzato l'importanza delle province interne e secondarie della Cina.

Company	Beijing	Shanghai	Guangzhou	Chengdu	Hangzhou	Nanjing	Others
 Lufthansa	28	21	×	×	×	5	Shenyang Qingdao
 Emirates	14	14	7	×	×	×	×
 AIRFRANCE	14	14	7	×	×	×	Wuhan
 KLM	7	7	7	2	4	×	Xiamen
 QATAR	7	7	7	3	4	×	×
 BRITISH AIRWAYS	7	7	×	5	×	×	×
 Alitalia	×	3	×	×	×	×	×
 TURKISH AIRLINES	7	7	7	×	×	×	×

Per confermare la nostra tesi abbiamo guardato le maggiori compagnie aeree Europee che hanno come destinazione la Cina.

Abbiamo preso in considerazione solo i voli diretti operati dalle compagnie stesse. La tabella qui sopra riportata, riassume la frequenza settimanale dei voli e le destinazioni operate.

Quasi tutte le compagnie offrono collegamenti con Shanghai e Pechino almeno una volta al giorno. Lo stesso però non accade per le altre provincie cinesi dove i voli (se disponibili) sono operati da più di una compagnia e necessitano almeno uno scalo. Un volo verso una sola città cinese equivale a volare solo a Parigi in Europa. Come sappiamo un collegamento del genere non è abbastanza per affermare che la Cina sia ben connessa con il continente europeo.

Auspiciando che l'iniziativa di riaprire i voli a questa parte dell'Asia si prolunghi oltre la fine dell'Expo, vorremmo dare un piccolo suggerimento ad Alitalia e non solo.

Invece di lottare per pochi slot nelle più note province in cui stabilire un vero e proprio vantaggio competitivo risulta difficile, si potrebbero invece collegare altre importanti città. Per esempio, Wenzhou, nella provincia dello Zhejiang, presenta una popolazione di più di 6 milioni di abitanti e con maggiore affluenza di Cinesi risiedenti in Europa e in Italia. Un collegamento diretto tra Firenze o Pisa e questa città sarebbe auspicabile, anche per favorire il turismo nel cuore dell'Italia.

Altre tratte potrebbero collegare l'Europa a città come Harbin, Kunming e Chongqing nella zona centro/sud-ovest del continente Cinese. Chongqing in particolare è recentemente diventata sede di un consolato Italiano.

Dobbiamo guardare dove altri non sono ancora presenti. Essere creativi e più aggressivi nel mercato sono l'unico modo di garantirsi un vantaggio competitivo sostenibile e duraturo.

## How close is Alitalia to China?

By Saro Capozzoli, Giulia Radice, Francesca Pozzan, Edoardo del Pia – Jesa

From May the 1<sup>st</sup> 2015 Alitalia will inaugurate the new flight from Milano Malpensa Airport to Shanghai. The new route having as destination the largest city in terms of population of the Republic of China arrives in concurrence with the start of Expo Milan 2015, a major event that is most luckily going to encourage tourism and investments in Italy. Why such a major investment, aiming at supporting Italian exports in the East, came so late?

In order to answer this question and clarify what this route has been going through in the last decade, a few remarks should be done. In the 90s, when the potential of Shanghai as a major hub for companies and investors was not fully mature and exploited, the Italian national airline was one of the first companies in Europe to offer its passengers a direct flight to this centre. The Company “first mover” advantage did not last long. The Italians moving to Shanghai were not so many at a time when the focus used to be on Beijing. Early enough Alitalia decided to suppress such a route while the fast rise of Shanghai was catching the attention of new competitors starting the race between airlines for new non-stop Chinese destinations.

While September 2001 events were not helping the airline sector in general, Alitalia was the only Company deciding to stop its route to Beijing. Meanwhile, rivals like Lufthansa and AirFrance, were catching the new generation of customers that demanded flights for routes,

which, beside Shanghai and Beijing, included Chengdu, Guangzhou as well as minors airports like the ones in Nanjing, Wuhan, Xiamen. At that time, in the down turn of the market, many airlines decided to move to East; Malev, Turkish Airlines, and the traditional airlines increased their connections and frequency. While Lufthansa had three daily flights connecting Shanghai to Munich and Frankfurt, Alitalia decided to quit with China.

In 2008, a cut cost strategy, after a few years reopening, led to the cancellation of direct flights to Shanghai. The loss of money that Alitalia was experiencing at that time on this route can be associated to different factors. While Alitalia kept on using old Boing 767, close competitors had already shifted to bigger and modern planes like the 747, 777 and A340. At the same time, the Airline offer focusing much more on the needs of the Italian clientele was missing the opportunity to satisfy the Chinese ones. Last, but not least, the low frequency of flights from and to China made Alitalia’s offer less attractive and more costly (it is common knowledge that more flights are needed in order to decrease fixed, logistic and personnel costs).

We are wondering why the cost structure was so high compared to other airlines. Even though we have an idea about it, we are not here to discuss the reasons behind such choices and the management decisions that led to it.

It is enough to say that the news of the reopening of non-stop flights from and to China is a good opportunity for both the company, the city of Milan and the whole North East of Italy.

In fact, we do not believe that Veneto's passengers will chose to travel from Malpensa given the traffic blocked A4 and Milano area. Until important hubs like Malpensa and Linate's Airports will not be easily reachable from the Eastern part of Italy, they will not be passengers' first choice. In this case, the closer Verona and Venice airports offer very good and fast connections through Frankfurt, Munich, Amsterdam and Vienna to the rest of the world.

As we have already pointed out in our previous newsletter, the growing importance of other major Chinese cities should not be underestimated. Alitalia, together with most of its European competitors, has not realized the potential of internal and secondary provinces yet. In order to prove our point we looked at European major Airlines' flights to China taking into consideration only direct flights operated by the companies analysed. On the right, a table with the weekly frequency to/from Europe.

China is a continent and flying only to one of its cities equals flying to Europe just trough Paris. As we all know, such a little connection is not enough to say that the Chinese Republic is well connected to the European Union.

Almost every Airline has flights with destination Shanghai and Beijing at least once a day. The same does not happen for other Chinese provinces which flights (if available) are usually operated by more than one company and have at least one stop. The problem, already pointed out in analysing the overall GDP of China, can be linked to a non-realistic view of foreigners of a country represented by few cities.

Company	Beijing	Shanghai	Guangzhou	Chengdu	Hangzhou	Nanjing	Others
 Lufthansa	28	21	×	×	×	5	Shenyang Qingdao
 Emirates	14	14	7	×	×	×	×
 AIRFRANCE	14	14	7	×	×	×	Wuhan
 KLM	7	7	7	2	4	×	Xiamen
 QATAR	7	7	7	3	4	×	×
 BRITISH AIRWAYS	7	7	×	5	×	×	×
 Alitalia	×	3	×	×	×	×	×
 TURKISH AIRLINES	7	7	7	×	×	×	×

While wishing that the initiative to reopen flights to this part of Asia would last longer than the Expo we would like to give a little hint to Alitalia as well as to other European companies.

There are many routes in which there are no direct flights from EU and in which major airlines may go instead of fighting for few slots in places where establishing a true competitive advantage is difficult. As an example the city of Wenzhou, a part Zhejiang's province reaching a population of 6 million, is still not well connected even though this is one of the metropolis from which the biggest part of Chinese living in Europe come from. A direct flight from cities like Florence and Pisa to this destination would favour tourism also in the centre of Italy.

Other airlines do not touch the south-west/central zone of China, like Harbin and cities like Kunming and Chongqing, a centre the latter,

where Italy has opened a new consulate. We should look where other are not yet present. Being creative and a bit more aggressive is the only way to get more market share.

**Chinese market financing opportunities: the new Third Board**

By Saro Capozzoli, Giulia Radice, Francesca Pozzan, Edoardo del Pia Scott Sun, Enrico Borsari– Jesa

Starting from January the 7<sup>th</sup> 2014, all qualified joint-stock companies from across China were allowed to apply for listings on the new Chinese OTC market, namely the Third Board Exchange (National Equities Exchange and Quotations, NEEQ).

By the end of 2014, the new Chinese OTC market has increased ten-fold. Translated into numbers, companies traded on the National Equities Exchange and Quotations have increased from 350 to 1271. The reason behind this outstanding growth can be found in the board modernization process carried out during the last few months.

As a matter of fact, the concept of OTC market is anything but new in the Chinese reality. Rudimentary OTC markets have existed since 1993 – see Zibo Automated Quotation System, a regional market for shares in township and village enterprises, but most of times the shares were traded to employees only, as a result of a right issue.

The very first regulated OTC market was established in 2001. The purpose was to reallocate the stocks traded on STAQ and NET before their shutdown imposed by the Central Financial Work Commission (1999) and create a “shares collector” for companies delisted from the Main Board. The old Third Board received since then two further expansions.

The first, in 2006, allowed companies incorporated in Zhongguan Science Park to take part to transactions; the second one, in 2013, extended the market scope to other four “Hi-Tech” industrial parks.



Figure 1: Chinese Actual Exchange and OTC composition

China has two public stock exchange markets: the Shanghai Stock Exchange (SSE) and the Shenzhen Stock Exchange (SZSE). Both exchanges operate the main board while just one of them, SZSE, operates the Small and Medium Size Board and the ChiNext. While the second Board uses the same regulations of the main Board but is directed toward SMEs, ChiNext has less stringent criteria and it is directed toward companies in their early stage of development.

In spite encouraging premises –China’s industrial tissue is composed by 98% of SME, which roughly the 88% was and still is in lack of financing channels; firsts OTC “versions” failed to address the interest of micro-, small and medium enterprises. Lack of liquidity and financial disclosure irregularities, together with thin margins offered to securities companies, created a vicious cycle resulting in Board participants’

lack of incentives. The persistence, over years, of low valuations performed as a real “bottleneck”, further drying the liquidity up.

In December the 14th, 2013, to recover from this sluggish growth and reaffirm the Third Board as the main SME financing incubator in China, which counts others 26 over-the-counter markets more, China Securities Regulatory commission issued a revised regulation on unlisted public companies and seven supporting rules for National Equities Exchange and Quotation. According with the tenfold growth registered all over this year, the new guidelines, together with the Third Board expansion towards companies from all over China, instilled positive vibes to trades.

### **Unchanged Principles**

According to the new guidelines, the Third Board still features the basic characteristics of an over-the-counter market. That is, trade prices could differ for every transaction and do not need to be published, while traded products, instead of being standardized, could rather match unusual “quality” and quantity.

Trading methods are still the same used in the 2006 Board. Investors place orders with Securities companies, which quote prices on their quotation systems in order to find counterparties. Traders are free to look for counterparties without any automated system, but when it comes the negotiation, Securities Companies need to handle the matter. These Institutes are still required to obtain a license from SAC in order to operate in the market.

Even companies’ disclosure obligations are unaffected: the listed entities are required to fulfil information disclosure obligations, which must be authentic, accurate and complete.

Compared with Main Boards and ChiNext, the Third Board features a lower threshold for listing. No requirement on yearly and cumulative net profit is envisaged, while, conversely to Main Board’s requirements, listed companies are allowed to lose money. Eventually, anyone investing in the third board must already own an account for dealing in A shares on Shenzhen main board.

### **What might be about to change?**

Even though Regulator’s guidelines are not binding –some discrepancies with final rules will surely appear, expectations are very high.

What we can expect is the listing queue to be short, thanks to a less-than-40-days long listing period. Additional simplifications are expected to hit companies with no more than 200 shareholders. For them, when applying for board listing, there will be no need to wait for the Chinese Securities Regulatory Commission (CSRC) approval. In these cases, the approval is not going to be needed anymore, nor even when the number of shareholders would exceed 200 individual after the first stock transfer.

Although we believe that equity financing (common stocks and preferred shares) will be the main traded product in the exchange, companies that successfully pass the approval phase will be able to seek financing through company bonds as well.

In a certain way, even the object of trading is somehow changed. In fact, besides natural shareholder who gained shares through such channels as private placement, and investors recognized by the securities Association of China, only institutional investors are allowed to participate in the trading of shares.

Foreign investors with access to mainland capital markets via Qualified Foreign Institutional Investor (QFII) program will be allowed to invest as well.

Among others, the launch of a market-making system in Beijing might play a central role on Third Board's trading volume soaring. In a statement released by NEEQ on August the 18th, 2014, Beijing Third Board will be the first OTC market supplied with a pilot "market-making" system. Even if the trail is paved of uncertainties –brokerages approved to make markets must have deep cash reserves and risk management skills pretty advanced, when media first announced the advent of the new system, expectations climbed: in May the trading volume on the exchange hover almost 700%.

The realization of a market-maker "platform", for it will attract investors, is a primary contributor to exchanges lengthen. In the recent past, the absence of a market-maker system deterred large part of investors from trading small companies' high volatile stocks: traders in a given stock risk did not look kindly upon being kept waiting to complete a transaction.

Other than that, volumes' crucial boost hinges upon a formal clarification on shares' upgrade path.

So far, the regulator left unclear how companies listed on the Third Board could enter major exchanges. The lack of official confirmations cooled down the interest of High Tech SMEs', which are still waiting for policies allowing stocks' promotion to ChiNext.

Whether regulators will formally establish a shares' clear upgrade pathway, the Third Board will be finally able to truly mobilize a large portion of investors and speculators.

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Saro Capozzoli, fondatore di Jesa è stato eletto nuovo membro del Board della Camera.

Jesa guarda avanti ed è sempre alla ricerca di nuove opportunità e mercati per i propri clienti.

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